

ARGENTINA FINANCIAL SERVICES SECTOR PROGRAM

(AR-0266)

EXECUTIVE SUMMARY

Borrower:	Government of Argentina	
Executing agency:	Ministry of Economy, Secretary of Finance	
Amount and Source: ¹	IDB Sector Loan: (OC)	US\$ 500,000,000
	Technical Cooperation (TC) Loan	US\$ 2,000,000
	Local Counterpart of TC Loan:	US\$ 200,000
Financial terms and conditions :	<u>Sector Loan</u>	<u>Technical Cooperation Loan</u>
	Amortization Period: 20 Years	20 Years
	Grace Period: 5 Years	15 Months
	Disbursement Period: 12 Months	15 Months
	Interest Rate: Variable	Variable
	Supervision and Inspection: 1%	1%
	Commitment Fee: 0.75%	0.75%
	Currency: US Dollars from the Single currency facility	US Dollars from the Single currency facility
Objectives:	The proposed Financial Services Sector Program would support Government's efforts to implement major reform measures in the pension, insurance, and capital markets. The objectives of the reforms are to: (i) promote a competitive and financially sound market place; (ii) foster the delivery of high-quality and cost-efficient financial services to individual consumers and enterprises; (iii) improve governance of institutions and corporations; and (iv) strengthen and bring up to international standards the regulatory functions and enforcement capabilities of regulators.	
Description:	The Program is comprised of a fast-disbursing sector loan which would support the execution and implementation of major reforms in the pension, insurance and capital markets. It would be disbursed in two tranches of US\$250 million each and would be available upon submission of evidence satisfactory to the Bank that the first and second tranche conditions had been met. The operation also calls for technical cooperation consisting of a technical cooperation loan of US\$2 million. The technical cooperation loan would finance a series of studies that would provide a basis for second tranche policies and future reforms in the financial services markets, as well as finance the operations of the project implementation unit. The Program would be organized in four components: (i) macroeconomic framework; (ii) pension system reforms; (iii) insurance sector restructuring; and (iv) capital markets development.	
Conditions for Disbursement of the Sector Loan:	The pension system conditions for first tranche disbursement (listed in Section B.2 of Chapter II) are: (a) The pension system legal framework has been amended to: (i) authorize AFJPs to offer more than one fund to pension plan members; (ii) permit the elimination of the Stabilization Fund and credit funds to members' accounts; (iii) increase flexibility of investment policy by empowering the regulator to change the limits per category of investments up to 10 percentage points in any direction; (iv) increase flexibility in investment in shares; (v) introduce a commission structure for the AFJPs which is transparent and eliminates fixed fees; and (vi) eliminate the ceiling	

¹ This sector loan is accompanied by a Technical Cooperation Loan.

for lump sum withdrawal upon retirement (para. 2.11). **The conditions for second tranche disbursement** are: The basic legal framework for the pension system remains in force and regulations have been issued on: (i) content and design of the information to be regularly provided to affiliates (SAFJP); (ii) the ways that the AFJPs will be ranked monthly based on commissions costs (SAFJP); (iii) making investment policy more flexible including changing percentages and criteria for investing in shares (SAFJP); (iv) the characteristics of the new funds to be offered by the AFJPs to affiliates (Executive Power and SAFJP) (para. 2.12).

The insurance component conditions for first tranche disbursement (Section B.3 of Chapter II) are: (a) Introduce changes in the normative framework to settle and liquidate all claims of insurance companies against INDER (para. 2.15); (b) Agree with the Bank on the criteria to be used for the on-site comprehensive financial review to assess the actual net worth of general insurance companies and group them into categories and complete the review of at least one company (para. 2.17); and (c) Complete and present to the Bank a self-assessment to evaluate the degree of compliance with IAIS principles (para. 2.19). **The conditions for the second tranche** are: (a) Settle 100% of claims against INDER of companies accepting Option 1 (see para. 2.15) and pay in cash at least 28% of the total settled sum (para. 2.16); (b) Complete on-site reviews of at least 25 property and casualty insurance companies using criteria developed as a first tranche condition; (c) Prevent insurers with zero or negative net worth from issuing new or renewing existing insurance coverage; (d) Maintain norms requiring that undercapitalized companies be given not more than four months for compliance (para. 2.17); (e) Present to Bank an action plan for convergence of regulatory framework towards international standards having completed at least the implementation of the Supervisory Ladder (paras. 2.20 – 2.21).

The capital market component conditions for first tranche disbursement (Section B.4 of Chapter II) are: (a) Present to the Bank a draft proposal to amend the legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies; (b) Complete and present to the Bank a self-assessment to evaluate the degree of compliance with IOSCO principles (para. 2.25). **The conditions for the second tranche** are: (a) Issue the norm amending the legal framework relative to transparency and corporate governance standards consistent with OECD principles for publicly-traded companies (para. 2.25) and, (b) Present to Bank and announce to the public a Capital Market Policy Letter satisfactory to the Bank including at least the following areas: (i) enforcement capabilities of the Securities Regulator; (ii) requirements for issues in primary markets; (iii) structure and governance of secondary market institutions; (iv) clearing and settlement structure and guarantee systems; (v) entry requirements for intermediaries in different markets; (vi) prudential risk management requirements for intermediaries and market institutions; (vi) standards for internal organization and operational conduct for intermediaries and market institutions; and (vii) tax treatment among different financial instruments and services (para. 2.26).

Bank's country and sector strategy:

The Bank's economic and social growth strategy for Argentina for 2001-2003 period focuses on four objectives: (i) foster sustainable economic growth through raising the level of productivity promoting a favorable environment for investment and increasing competitiveness; (ii) reduce poverty and increase the quality of life of the population by raising employment opportunities and expanding coverage of basic social services; (iii) deepen the modernization of the national public sector and broaden reforms to encompass the provincial and municipal administrations, and (iv) deepen regional integration.

The proposed Financial Services Sector Program would contribute directly to

objective (I) and indirectly, to objectives (ii), (iii) and (iv). The Program would foster more active competition between market participants in the domestic and regional financial markets and would help reduce the operating costs of companies providing financial services. It would enhance the process of savings mobilization and investment and improve protection of investors' interests and consumers' decision-making through increased transparency of transactions and timely provision of financial information. It would also support measures to strengthen and bring up to international standards the supervisory functions and enforcement capabilities of the regulatory agencies. Additionally, it is expected that implementation of the Program would help the financial markets expand and open more employment opportunities.

**Environmental/
social review:**

The CESI has concluded that the proposed Program will have no direct environmental or social impact because all initiatives will be limited to legal and institutional reforms affecting the financial sector.

Benefits:

The policy measures supported by the Program are expected to contribute to improve competition among providers of financial services, which in turn should benefit consumers and investors through the availability of a wider choice of pension, insurance, and other saving and investment instruments. Enhanced competition should also lead to more efficiently priced, higher quality financial services.

By requiring that financial services' providers disclose more complete information on pension plans and insurance products, the Program will also better protect the property rights of consumers and investors. Minority shareholders would benefit from access to more transparent financial statements and enhanced rules of corporate governance.

The measures would help expand the fraction of the work force covered by retirement plans, the number of people protected by insurance policies, and the volume of transactions in the security markets. The expansion of these markets would generate value-added in the financial sector and contribute to raise employment.

Viability and risks:

Successful implementation of the Program requires active participation and coordination of efforts between various regulatory agencies and the Program Executing Unit (UEP) within the Ministry of Economy. The risks will be mitigated by the attention provided to coordination, assignments of responsibilities and technical support.

Another risk is associated with the technical capacity to design and implement the reforms associated with the Program. The Technical Cooperation Loan provides extensive support to the executing agency in terms of staffing and expert consultants most notably in the areas of insurance supervision and regulation and capital markets

The success of the Program also depends on the degree of support that the proposed reforms may generate among private sector companies and individuals that operate in the insurance, pension, and capital markets. In order to deal with the risks associated with this issue, a special consensus-building effort is being made by the UEP and the Superintendencies to engage and bring forward the contributions that interested parties of the private sector may make during the development of the new regulations and operating procedures. In addition to the events described in paragraph 3.4, the UEP and Superintendencies are planning a series of seminars and conferences to build consensus and exchange views with the private sector in order to build political support for the reforms and legislative changes. The risks of executing and implementing the Program will be mitigated by the arrangements made for coordination, assignments of responsibilities and technical support mentioned above.

The attainment of the Program objectives is also contingent upon the successful

implementation of a stable macroeconomic framework. The Government is committed to this goal and is pursuing a program with the IMF which includes macroeconomic measures including redressing the fiscal imbalance as described in Section A of Chapter I. At the moment, the macroeconomic situation is extremely difficult. However, the Government's commitment to improve the macroeconomic framework and its willingness to take the necessary measures, enhance the likelihood that it will be successful.

Finally, there is the risk that it will be politically difficult to undertake the reforms that are envisaged under the program. While the Government has experienced opposition to reforms, particularly in the face of the poor economic situation, it has been able to move at an accelerated pace to issue decrees on such thorny matters as changing the regulatory and supervisory framework of financial services and solving long-pending matters such as the situation of INDER. The political will of the government to institute these reforms appears unwavering. Although it has been difficult to build political consensus, thus far the record has been good and there is no reason to believe that it would deteriorate or be unsuccessful.

Special contractual clauses:

Those mentioned under Conditions for Disbursement.

Poverty-targeting and social sector classification:

Not applicable.

Exceptions to Bank policy:

None.

Procurement for the Sector Loan:

The fast-disbursing funds from the sector loan may be used to finance the aggregate cost in foreign exchange of eligible imports from the Bank's member countries. In this case, the Bank's procedures for sector loans, which do not require international competitive bidding, will be applied. The funds would be disbursed when requested by the borrower and evidence is presented that all the contractual conditions have been complied with.

Procurement for the TC Loan:

See Annex III